

Confirmation
Chapter 11

<u>In re Kern Family Services, Inc.</u>	698-64024-fra11
<u>In re Hull & Hull Funeral Home, Inc.</u>	698-64025-fra11
<u>In re Hawthorne Memorial Gardens, Inc.</u>	698-64026-fra11
<u>In re Southern Oregon Cremation Svcs, Inc.</u>	698-64027-fra11

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This opinion involves confirmation of the plan of reorganization proposed by the debtors-in-possession. The Debtors are in the mortuary and cemetery businesses. In June 1996, Kern Family Services acquired various related business in Medford. Less than a year later, members of the Kern family acquired the other three debtor businesses (all located in Grants Pass) with funds held in trust by the Medford businesses in a statutory trust created for the benefit of parties to "pre-need" arrangements with the funeral home. The use of these funds was unlawful and was discovered by the State of Oregon which initiated civil proceedings against the Debtors and others under the Unfair Trade Practices Act. Debtors and Charles Kern entered into an Assurance of Voluntary Compliance (AVC) with the state requiring Kern family interests be divested of the businesses with assurance that the pre-need parties be protected through replenishment of the statutory trust. The Debtors then filed bankruptcy and the cases were consolidated.

The Plan provides for creation of a "Buffer Trust" which will collect assets from all of the proponents, debtor and non-debtor alike, as well as collect the funds from a settlement with the entity which sold the Medford properties to the DIP. The assets of the Medford businesses will be used to capitalize a new corporation which will eventually be sold by the trustee when the market improves.

The Plan calls for complete satisfaction of all pre-need contracts as the needs arise, which is estimated to require \$5,100,000. The State of Oregon objected in part because it believes that the Plan provides for operation of cemetery businesses by an individual (the Buffer Trust Trustee) not licensed under state law. However, the Buffer Trust will simply function as owner - a license will be obtained by the new corporate entity and management which will actually operate the business. The Plan was approved over the objection of the State, the only objecting creditor, who would be paid in full. The secured claim of another creditor was satisfied by return of its collateral.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case No.
)	698-64024-fra11
KERN FAMILY SERVICES, INC.,)	
)	
Debtor.)	
In Re:)	Bankruptcy Case No.
)	698-64025-fra11
HULL & HULL FUNERAL HOME, INC.,)	
)	
Debtor.)	
In Re:)	Bankruptcy Case No.
)	698-64026-fra11
HAWTHORNE MEMORIAL GARDENS, INC.,)	
)	
Debtor.)	
In Re:)	Bankruptcy Case No.
)	698-64027-fra11
SOUTHERN OREGON CREMATION)	
SERVICES, INC.,)	AMENDED MEMORANDUM OPINION
)	
Debtor.)	

A plan of reorganization has been proposed by debtors-in-
possession, acting jointly with several non-debtor parties in
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1 interest. The Court finds that, with some conditions and
2 modification, the plan should be confirmed.¹

3 I. FACTS

4 The Debtors are in the mortuary and cemetery businesses. In
5 June, 1996, Kern Family Services, Inc. acquired various related
6 businesses in Medford, including Perl Funeral Homes and Siskiyou
7 Memorial Park. Less than a year later members of the Kern family
8 acquired Debtors Hull & Hull Funeral Home, Inc., Southern Oregon
9 Cremation Services, Inc., and Hawthorne Memorial Gardens, Inc., all
10 three of which are located in Grants Pass.

11 The acquisition of the Grants Pass properties was made with
12 funds held in trust by the Medford businesses in a statutory trust
13 created for the benefit of parties to "pre-need" arrangements with
14 the funeral home. This use of trust funds was unlawful, and the
15 beginning of the collapse of the Kern family's enterprise in Oregon.

16 Payment in advance for funeral services is a commonplace
17 transaction. In a typical month the "calls" made by a mortuary will
18 be evenly divided between families who contact the mortuary when the
19 need arises, and those who have paid for the funeral services in
20 advance by acquisition of a "pre-need contract."

21 Pre-need contracts are closely regulated by Oregon law. ORS
22 128.423 requires that, when a pre-need contract is sold, 90% of the
23 proceeds be paid into a trust. The funds held in trust guarantee
24 that money will be available for the funerary services when finally

25 ¹All modifications required by the court are permissible under
26 11 U.S.C. § 1127

1 needed. With few exceptions, the trust arrangement is revocable,
2 and the revoking customer is entitled to a refund of the entire
3 amount paid, together with interest on the 90% held in trust.

4 When a funeral business is sold, the trust holding the pre-
5 need funds is, for all intents and purposes, dissolved, and the
6 funds turned over to the purchaser. The purchaser is then required
7 to establish a new trust. When Kern Family Services acquired the
8 Medford businesses it placed the trust funds in an appropriate
9 depository. However, the funds were thereafter withdrawn and used
10 for impermissible purposes, including the acquisition of the Grants
11 Pass businesses and the acquisition and remodeling of an expensive
12 residence in Medford.² These transactions were discovered by the
13 State of Oregon, which initiated civil proceedings against the
14 Debtors and others under the Oregon Unfair Trade Practices Act. The
15 Debtors and Charles A. Kern entered into an Assurance of Voluntary
16 Compliance ("AVC") requiring that the Kern family interests be
17 divested of the businesses and that appropriate assurance be made
18 that all pre-need sales contract holders will be protected by
19 replenishment of the statutory trust. Shortly after the AVC was
20 signed, the Debtors filed bankruptcy petitions under Chapter 11, and
21 the cases were consolidated. This Court entered an order finding

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24 ² The debtors-in-possession have asserted that the depository,
25 United States National Bank, is at fault, and liable to the estate,
26 for allowing the withdrawal to occur. However, participation by
U.S. Bank, or payment of any sum by the Bank, is not an element of
the plan, and the Court makes no finding respecting this assertion.

1 that the AVC could be presented to the State Circuit Court for
2 approval.³

3 Since the time the consolidated cases were initiated, the
4 business have been run by a professional management firm engaged by
5 the Debtors-in-Possession. Under this management, a sale of the
6 Grants Pass businesses has been negotiated. The Medford businesses
7 have run at a slight loss, at least when viewed on a cash basis.
8 This is attributable to the DIP's continued service to pre-need
9 contract holders, even though the trust funds which would pay for
10 these services are unavailable pending reorganization.

11 II. THE PLAN

12 The plan is an effort by the Debtors and the Kern family to
13 comply with the AVC, and reorganize their obligations with respect
14 to the pre-need claimants and the companies' other creditors. The
15 proponents are the debtor-in-possession, Siskiyou Memorial Park
16 ("SMP"), Shirlee Kern, and Charles Kern, individually and as trustee
17 of the Kern Family Trust.

18 The plan provides for creation of a "Buffer Trust" which will
19 collect assets from all of the proponents, Debtors and non-debtor
20 alike. In addition, the trustee would receive funds from a
21 settlement between the debtors-in-possession and Uniservice, which

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23 ³ It is important to be precise here: the AVC is subject to
24 approval by state, rather than federal courts. Nothing in the
25 Court's prior order, or in this opinion, should be construed as
26 being in derogation of the State Court's jurisdiction over the AVC,
and its authority to enforce or approve modifications to it. Nor
does this Court intend to limit the State's authority to enforce the
AVC.

1 sold the Medford properties to them. A settlement is expected to be
2 reached providing for a sum sufficient to help fund the plan;
3 however, Uniservice and the proponents agree that the discussions
4 are still open, and that there is no basis for the Court to make any
5 finding regarding any duty of Uniservice to make any payment.

6 These assets, plus the assets of the corporate debtors, will
7 be transferred unconditionally to the Buffer Trust. The Medford
8 businesses, or their assets, will be used to capitalize a new
9 corporation, Ocwen, Inc. It is contemplated that the trustee will
10 hold the new business for a reasonable period of time, in order to
11 ride out a relatively depressed market in funeral businesses, and
12 then sell it at a better price. (There was uncontradicted testimony
13 that the market's present low condition is temporary, it should take
14 no more than two years to liquidate the Medford business.)

15 The terms of the sale of the Grants Pass business provide
16 that \$800,000 be held in escrow to cover claims for a period of two
17 years. Thereafter, the escrowed funds would be available to the
18 Buffer Trustee.

19 The plan calls for complete satisfaction of all pre-need
20 contracts as the needs arise. It is estimated that this will
21 require \$5,100,000. According to the testimony at trial, the assets
22 contributed to the Buffer Trust will be adequate for this purpose.
23 Moreover, there is testimony from which the Court can find that the
24 Buffer Trust will receive sufficient funds to provide to a purchaser
25 of the Medford businesses all the funds required by state law to be
26 held in trust to cover pre-need contracts.

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2 III. ACCEPTANCE AND REJECTION

3 A disclosure statement was approved by the Court and ballots
4 delivered to creditors. Throughout the case the Court and the
5 parties wrestled with how to treat the holders of pre-need
6 contracts. At the outset the Debtors argued that these holders had
7 claims against the statutory trust, but not the Debtors themselves.
8 At first the Court accepted this view. As the case progressed, this
9 view evolved, and eventually the parties and the Court came to the
10 conclusion that the pre-need contract holders were, at very least,
11 contingent creditors. This gave rise to some difficulty, given the
12 large number of such claimants, and the chaotic records of the
13 Debtor and its predecessors regarding these contracts. With Court
14 approval, a condensed version of the disclosure statement was
15 circulated to holders of these contracts, who are deemed to be
16 members of an unimpaired class under the plan.

17 Ballots were duly issued and returned. Since their class is
18 unimpaired under the plan, no ballots were sent to the holders of
19 pre-need contracts. 11 U.S.C. § 1126(f). (A class that is not
20 impaired under a plan, and each holder of a claim in that class, is
21 conclusively presumed to have accepted the plan.)

22 All the voting classes cast ballots accepting the plan, with
23 the exception of the State of Oregon. Desert Community Bank did not
24 cast a ballot, but advised at the hearing that it accepted the plan.
25 A secured creditor, Copelco Capital, did not vote. As will be seen,
26

1 the plan can be confirmed notwithstanding the dissenting and
2 nonvoting classes.

3 IV. CONFIRMATION

4 The Court may confirm the plan of reorganization only if it
5 finds that all of the requirements of 11 U.S.C. § 1129 have been
6 satisfied. Substantial evidence has been presented to the Court
7 supporting a finding that each of the elements of § 1129 have been
8 satisfied. In light of the legal complexities involved, and
9 objections raised by interested parties, the following elements
10 deserve more detailed discussion:

11 1. Good Faith

12 Section 1129(a) (3) requires that "the plan has been proposed
13 in good faith and not by any means forbidden by law." Transnation
14 Title Insurance Company has objected to confirmation asserting,
15 among other things, that the plan was not proposed in good faith.

16 Transnation is in a peculiar position in this case. Siskiyou
17 Memorial Park is an Oregon nonprofit corporation, and not a debtor.
18 The parties dispute whether when Uniservice sold the Medford
19 businesses to Kern Family Services, Siskiyou Memorial Park, a
20 cemetery situated in the City of Medford, was one of the assets
21 being transferred. Strictly speaking, however, the cemetery is
22 owned by SMP, which remained a separate entity. What was conveyed,
23 if that is the correct term, was not the property, but control of
24 the nonprofit corporation's board of directors. Sometime thereafter
25 the Trust borrowed \$1,200,000 against the property from Desert
26 Community Bank, which obtained title insurance from Transnation to

1 protect its security interest. It is now asserted in an adversary
2 proceeding by Siskiyou Memorial Park, Inc., that the real property
3 belongs to it, and not the Kern Family Trust, or anyone else. It
4 follows, according to the complaint, that the security interest did
5 not attach, and that title should be quieted in SMP's favor.

6 Transnation has \$1,200,000 at risk here, and has stated its
7 concern that it is being abused in litigation in which the Kerns
8 control "both ends" of the litigation. Transnation also suggests
9 that the Kerns, who are shareholders in Desert Community Bank, are
10 controlling the Bank's actions as well.

11 It appears from testimony provided at the hearing that the
12 Kerns' interest in the Bank is not sufficient to control the Bank's
13 actions. Moreover, the court takes judicial notice that the Bank
14 has filed an answer and counterclaim in the adversary proceeding
15 seeking reformation of the title instruments to reflect that its
16 borrower took title to the property at the time the businesses were
17 sold.

18 Transnation's concerns about the litigation are
19 understandable -- any \$1.2 Million claim should be cause for
20 concern. However, these concerns do not provide any reason to deny
21 confirmation of the plan. First, success of the plan is not
22 premised on the outcome of the litigation. The value of the
23 Siskiyou Memorial Park property, which will be contributed to the
24 Buffer Trust, is presumed to be net of the Bank's secured claim.
25 Second, the objection presumes that the adversary proceeding will
26 necessarily have an unjust outcome. Since the adversary proceeding

1 is before this Court, the notion is not one that the Court is
2 inclined to accept. If the SMP claim is inappropriate as a matter
3 of law or equity it should be presumed, at least for purposes of
4 this matter, that the Court's judgment will reflect as much. On the
5 other hand, if SMP is entitled to prevail, even if ultimately at
6 Transnation's expense, then beneficiaries of the plan should benefit
7 as well. In short, the plan should not be denied confirmation
8 because of the unusual nature of what is purely collateral
9 litigation. Since the plan can work either way, the litigation does
10 not bear on this Court's findings either of good faith or of
11 feasibility.

12 2. Feasibility

13 The Court must find that confirmation is not likely to be
14 followed by the need for further reorganization. 11 U.S.C.
15 § 1129(a)(11). In addition, trustees appointed pursuant to the plan
16 must comply with applicable state law. 28 U.S.C. § 959.

17 The State of Oregon has objected in part because it believes
18 that the plan unlawfully provides for operation of cemetery
19 businesses by an individual not qualified under ORS Chapter 692:

20 **692.025 License required for funeral service**

21 **practitioner...**(1) An individual may not practice as a
22 funeral service practitioner unless the individual is
23 licensed as a funeral service practitioner under ORS
24 692.045. An individual practices as a funeral service
25 practitioner if the individual for payment is engaged
26 directly or indirectly in supervising or otherwise
controlling the transportation, care, preparation,
processing and handling of dead human bodies before
the bodies undergo cremation, entombment, or
burial....

1 The plan, as noted, contemplates collection of the assets by
2 the Buffer Trust, and creation of a new funeral business which can
3 then be sold as a going concern. The business itself will
4 immediately seek to become qualified to operate a funeral business.
5 Under the plan the buffer trust will simply function as owner and,
6 ultimately, seller, of the newly constituted funeral business.
7 Neither the trust nor the trustee will, directly or indirectly,
8 supervise or control the business' operations, and will not be
9 involved in supervising or controlling the activities described in
10 the statute. The new business, and its management, must themselves
11 comply with Oregon law by obtaining appropriate licenses. However,
12 the trustee of the buffer trust is not subject to the licensing
13 statute.⁴

14 Interested parties have raised concerns about the plan's
15 feasibility if the proposed contribution of assets does not occur
16 when required. This concern is met in part by the fact that each of
17 the proponents, by having joined in presentation of a plan to the
18 Court, has submitted him or herself to the Court's jurisdiction. It
19 follows that the Court may order compliance, and exercise control
20 over the assets to be contributed. Concerns about feasibility can
21 further be allayed by provision that the plan not be deemed
22 substantially consummated until all the property proposed to be
23

24 ⁴ The State has also objected to a provision allowing the
25 Buffer Trustee to buy insurance to cover liability to preneed
26 claimants. This is a common device, but one not authorized under
Oregon law. Since the use of insurance is not required at this
point, the parties agreed that the issue is not ripe for decision.

1 contributed is in fact transferred to the trustee of the Buffer
2 Trust.

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4 3. Cramdown

5 The State of Oregon is the only dissenting creditor. The
6 plan proposes to pay it in full, and further provides that, until
7 and unless payment in full is made, no junior class will receive any
8 payment. Moreover, the plan provides for payment in full of the
9 pre-need claims by a complete replenishment of the trust, as
10 required by the AVC. Finally, the Kern family is willing to accept
11 a requirement that the State and Buffer trustee be notified if any
12 other family asset⁵ is to be encumbered or transferred. I find that
13 the plan should be confirmed notwithstanding the State's objection.
14 11 U.S.C. § 1129(b)(2)(B)(ii).

15 The secured claim of Copelco Capital is satisfied by return
16 of its collateral, qualifying the class for cramdown under
17 11 U.S.C. § 1129(b)(2)(A)(iii).

18 V. CONCLUSION

19 The proposed plan complies with Code § 1129, and may be
20 confirmed. The order confirming the plan shall provide that the
21 effective date, and substantial consummation, shall be such time as
22 all assets to be transferred to the buffer trust have in fact been
23 transferred.

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25 ⁵ Assets retained by the family include a condominium in
26 Lahaina and a contract providing income to Charles Kern. The Kern's
residence in California is to be transferred to the Buffer Trust.

1 The order shall include a provision specifically and directly
2 enjoining the proponents, and each of them, to effect the transfer
3 of property to the buffer trust contemplated by the plan, as soon as
4 is practicable. Transfers of real property shall be by statutory
5 warranty deed. The order shall further provide that BR 7070 and
6 FRCP 70 are made applicable to the order pursuant to BR 9014.

7 Finally, the order confirming the plan should provide that
8 the proponents shall advise interested parties in the event they
9 propose to encumber or transfer any asset other than those
10 transferred to the buffer trust under the plan.

11 The foregoing constitutes the Court's findings of fact and
12 conclusion of law. Counsel for the Debtors-in-Possession shall
13 tender a form of confirmation order consistent with this Memorandum.
14 Alternatively, the Debtors-in-Possession may submit a fourth
15 modified amended plan incorporating the requirements set out in this
16 memorandum, and a form of order confirming the modified plan.

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20 FRANK R. ALLEY, III
21 Bankruptcy Judge
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